

DEPARTMENT OF TAXATION

2010 Fiscal Impact Statement

1. **Patron** Kathy J. Byron

2. **Bill Number** HB 1122

3. **Committee** Senate Finance

House of Origin:

☐ Introduced

☐ Substitute

☐ Engrossed

4. **Title** Corporate Income Tax: Apportionment of
Income for Manufacturers

Second House:

☒ In Committee

☐ Substitute

☐ Enrolled

5. **Summary/Purpose:**

This bill would eliminate the requirement that a manufacturer electing to use the single sales factor apportionment method for corporate income tax maintain a base year level of employment in the Commonwealth for the first three taxable years after making the election. This bill would also eliminate the provisions assessing additional taxes, penalties and interest for failing to meet this requirement.

In addition, this bill would eliminate the non-severability clause, which ensures that the tax benefits related to single sales factor apportionment can never be claimed by manufacturers that do not maintain or expand employment in Virginia.

The effective date for these changes would be July 1, 2010.

6. **Fiscal Impact Estimates are:** Preliminary. (See Line 8.)

7. **Budget amendment necessary:** No.

8. **Fiscal implications:**

Administrative Impact

TAX has not assigned any administrative costs to this bill because the changes required by a single bill such as this can be implemented as part of the annual changes to our systems and forms. TAX considers implementation of this bill as "routine," and does not require additional funding.

Revenue Impact

The revenue impact of this bill is unknown. When the single sales factor apportionment was enacted in 2009, TAX did not assign any revenue impact to the tax, penalty and interest provisions being repealed by this bill. In addition, it is unknown how many manufacturers would lower their employment rates after electing to use single sales factor apportionment if this bill is enacted.

9. Specific agency or political subdivisions affected:

Department of Taxation

10. Technical amendment necessary: No.

11. Other comments:

Background

In Virginia, multistate corporations are generally required to use a three-factor formula of property, payroll and double-weighted sales. The sum of the property factor, payroll factor and twice the sales factor is divided by four to arrive at the final apportionment factor. This amount is then multiplied by Virginia taxable income.

The property factor is a fraction, the numerator of which is the average value of the corporation's real and tangible personal property owned and used or rented and used in Virginia during the taxable year, and the denominator of which is the average value of all the corporation's real and tangible property owned and used or rented and used during the taxable year and located everywhere; to the extent that such property is used to produce Virginia taxable income and is effectively connected with the conduct of a trade or business within the United States and income derived is includible in federal taxable income.

The payroll factor is a fraction, the numerator of which is the total amount paid or accrued in Virginia during the tax period by the corporation for compensation, and the denominator of which is the total compensation paid or accrued everywhere during the tax period; to the extent that such payroll is used to produce Virginia taxable income and is effectively connected with the conduct of a trade or business within the United States and income derived is includible in federal taxable income.

The sales factor is a fraction, the numerator of which is the total sales of the corporation in Virginia during the tax period, and the denominator of which is the total sales of the corporation everywhere during the tax period, to the extent that such sales are used to produce Virginia taxable income and are effectively connected with the conduct of a trade or business within the United States and income derived is includible in federal taxable income.

Prior to 1999, the property, payroll, and sales factors were weighted equally. In 1999, the formula was changed so that the sales factor was double counted. According to the Federation of Tax Administrators, as of January 1, 2008, at least sixteen other states also have a sales factor of 50%. Eleven states still utilize the standard three factor formula, and three states have a sales factor between 50% and 100%. An additional seventeen states either currently have, or will have within the next five years, a sales factor of 100% for either all taxpayers or for specified industries. These states are Connecticut, Georgia, Illinois, Indiana, Iowa, Kentucky, Louisiana, Maryland, Michigan, Minnesota, Missouri, Nebraska, New York, Oregon, South Carolina, Texas, and Wisconsin.

2009 Legislation

Apportionment:

In 2009 legislation was enacted (2009 Acts of Assembly, Chapter 821, House Bill 2437) that modified the corporate apportionment formula by allowing manufacturing companies to use a single sales factor to determine their Virginia taxable income. This modification will be phased in as follows: for taxable years beginning on or after July 1, 2010, but before July 1, 2012, qualifying corporations may elect to use a triple-weighted sales factor; for taxable years beginning on or after July 1, 2012, but before July 1, 2013, qualifying corporations may elect to use a quadruple-weighted sales factor; and for taxable years beginning on or after July 1, 2013, and thereafter, qualifying corporations may elect to use the single sales factor method to apportion Virginia taxable income. A manufacturer that elects to use these methods may not change for three taxable years.

Under this law a “manufacturing company” is defined as a domestic or foreign corporation which is primarily engaged in activities that, in accordance with the North American Industrial Classification System (NAICS), United States Manual, United States Office of Management and Budget, 1997 Edition, would be included in Sector 11, 31, 32, or 33. This would include the sectors of agriculture, forestry, fishing, and hunting and manufacturing.

Employment Qualification:

A taxpayer making the single sales factor election is required to certify to TAX that the average weekly wages of its full-time employees is greater than the lower of the state or local average weekly wages for the taxpayer’s industry.

In addition, corporations are required to maintain a base year level of employment in the Commonwealth for the first three taxable years after electing to use a single factor apportionment based on sales. If a corporation does not satisfy this criterion, TAX is directed to assess the corporation the difference between taxes calculated under the standard apportionment in which sales are double-weighted and sales-only apportionment. In addition, a ten percent penalty will be assessed; and interest will accrue.

Non-severability Clause:

The legislation enacted in 2009 also contains a non-severability clause to prevent all manufacturers from being able to elect the single sales factor method of apportionment. The Major Business Facility Jobs Tax Credits contains a similar clause. Without this non-severability clause there is no surety that the tax benefits can never be claimed by those for whom it was not intended.

This requirement was added to the 2009 legislation because the U.S. Supreme Court has ruled multiple times that providing a tax benefit that discriminates against out-of-state businesses violates the Commerce Clause of the U.S. Constitution. If this provision was not added and a manufacturer was denied the election of this more favorable

apportionment formula because it shifted employees from Virginia to other states, the constitutionality of the in-state limitation could be placed in issue.

Proposed Legislation

This bill would eliminate the requirement that a manufacturer electing to use the single sales factor apportionment method for corporate income tax maintain a base year level of employment in the Commonwealth for the first three taxable years after making the election. This bill would also eliminate the provisions assessing additional taxes, penalties and interest for failing to meet this requirement.

In addition, this bill would eliminate the non-severability clause, which ensures that the tax benefits related to single sales factor apportionment can never be claimed by manufacturers that do not maintain or expand employment in Virginia.

The effective date for the changes to the conditions under which single sales factor apportionment is allowable would be July 1, 2010.

cc : Secretary of Finance

Date: 2/19/2010 TG
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